



**Department of the Treasury
Internal Revenue Service**

P.O. Box 2508
Cincinnati, OH 45201

Release Number: **201551010**
Release Date: 12/18/2015
UIL Code: 501.07-00

Date: September 23, 2015

Employer ID number:

Contact person/ID number:

Contact telephone number:

Form you must file:

Tax years:

Dear _____ :

This letter is our final determination that you don't qualify for tax-exempt status under Section 501(c)(7) of the Internal Revenue Code (the Code). Recently, we sent you a proposed adverse determination in response to your application. The proposed adverse determination explained the facts, law, and basis for our conclusion, and it gave you 30 days to file a protest. Because we didn't receive a protest within the required 30 days, the proposed determination is now final.

You must file federal income tax returns for the tax years listed at the top of this letter using the required form (also listed at the top of this letter) within 30 days of this letter unless you request an extension of time to file.

We'll make this final adverse determination letter and the proposed adverse determination letter available for public inspection (as required under Section 6110 of the Code) after deleting certain identifying information. Please read the enclosed Notice 437, *Notice of Intention to Disclose*, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in the Notice 437 on how to notify us. If you agree with our deletions, you don't need to take any further action.

If you have questions about this letter, you can contact the person listed at the top of this letter. If you have questions about your federal income tax status and responsibilities, call our customer service number at 1-800-829-1040 (TTY 1-800-829-4933 for deaf or hard of hearing) or customer service for businesses at 1-800-829-4933.

We sent a copy of this letter to your representative as indicated in your power of attorney.

Sincerely,

Jeffrey I. Cooper
Director, Exempt Organizations
Rulings and Agreements

Enclosures:

Notice 437

Redacted Letter 4034, *Proposed Adverse Determination under IRC Section 501(a) Other Than 501(c)(3)*

Redacted Letter 4040, *Final Adverse Determination under IRC Section 501(a) Other Than 501(c)(3) - No Protest*



Department of the Treasury
Internal Revenue Service
 P.O. Box 2508
 Cincinnati, OH 45201

Date: August 3, 2015

Employer ID number:

Contact person/ID number:

Contact telephone number:

Contact fax number:

Legend:

B = Name
 C = Date
 D = Name of Law
 F = State
 M = LLC Name

UIL:

501.07-00
 501.07-02
 501.07-05

r = Number
 s = Number
 t dollars = Amount
 u dollars = Amount
 v dollars = Amount
 w = Number
 x = Number
 y = Number
 z = Number

bb= Number
 cc= Number
 dd= Number
 ee= Number
 ff= Number

Dear :

We considered your application for recognition of exemption from federal income tax under Section 501(a) of the Internal Revenue Code (the Code). Based on the information provided, we determined that you don't qualify for exemption under Section 501(c)(7) of the Code. This letter explains the basis for our conclusion. Please keep it for your records.

Issues

Do you qualify for exemption under section 501(c)(7) of the Code? No, for the reasons stated below.

Facts

You were formed in the state of F on C as an unincorporated association. Your Articles of Association state you were organized to create a private club that "will be for the pleasure and enjoyment of its members, their

families and guests, and arrange for suitable facilities at a premise where activities of a hospitable, social, and fraternal nature may be conducted as a private club in accordance with D." D is the law in F concerning requirements for private club alcohol licenses.

You claim to be a social club operating for the pleasure and enjoyment of your members, their families and guests. You will begin sometime in the first quarter of the current year; you will apply for and obtain a Private Club Alcohol permit and serve alcohol to members in accordance with D.

You will have one class of members. The qualifications and rights of such class are as follows:

1. All members shall be of legal drinking age.
2. Members must submit an application and be approved by the membership committee.
3. Dues for membership, if any, shall be determined by the board of directors.
4. Charter member dues are v dollars. Non-charter members do not pay dues.
5. Members may bring guests to the club, but the guests may not pay for the service of alcoholic beverages at any time.
6. There is no limit to the number of guests a member may bring.

Your bylaws indicate you will operate according to the pool system in accordance with F state law. F state law requires you to have an operating account and an alcohol replenishment account under the pool system; your members will contribute equally to the initial purchase of alcohol that is to be stored on club premises. The initial replenishment percentage shall be w% for each gross service ticket for alcohol served to the members and their guests. The percent will be determined by the board of directors and may be changed as needed by the board.

Your bylaws, in addition, indicate your Membership Committee is appointed by your Board of Directors and consists of a minimum of three members of the club. The committee shall meet within seven days to act on membership applications received and shall meet, act, and record minutes of the meetings in accordance with D. Additionally, employees of the club shall not be eligible to be on the Membership Committee per D.

You are governed by two board members, a President and a Secretary. Your president, B, is the owner of M, a limited liability company, which is a for profit event planning venue. You have executed a management contract and a lease agreement with M as well as a loan agreement; B signed and agreed to the terms of these agreements/contracts on behalf of both you and M.

The management contract indicates M is being paid r% of the gross alcohol service tickets sales as a management fee. Some of the provisions in the management agreement are:

1. The manager shall accept applications for membership in the club and shall provide applications for membership to the club's membership committee within seven days of receiving such application.

2. The manager shall comply with the F Alcohol Beverage Commission, its rules and regulations and cooperate with agents and representatives and all other law enforcement officers,
3. The Manager and staff shall serve from the Club's pool system of alcoholic beverage storage, only to members of the Club, their families and guests, by the drink or in sealed, unsealed or broken containers of any legal size, for on premise consumption only, in accordance with D

The lease agreement shows M is being paid an additional s% of the gross alcohol service tickets to lease the venue. The lease agreement also stipulates that you must apply for and obtain a private club alcohol permit and serve alcohol to members.

You received a loan from M. The loan agreement shows the loan is in the amount of t dollars and must be paid within two years of issuance at an interest rate of x percent. Furthermore, M has offered you a gift of u dollars but you must obtain an F private club alcohol permit to qualify for this gift. Your Form 1024 shows that M believes the alcohol permit will greatly benefit its business.

In the first year of operations, disbursements for the benefit of members for alcohol purchases total bb% of gross receipts; cc% of gross receipts are budgeted for taxes, and as per your agreements with M, dd% of gross receipts are fees paid to M. There is less than percent remaining after all disbursements.

In the second year, you project gross income to increase by %. Disbursements for the benefit of members for alcohol purchases total ee%. Disbursements for taxes and state renewal fees total ff%. And as per your agreements, dd% of gross receipts is fees paid to M. There is zero percent remaining after all disbursements.

Your Rules and Regulations document provides, in part, that persons may become regular members by providing the required information and the payment of your annual membership which is currently set at zero. Members may also bring guests to the club but only members may pay for the service of alcoholic beverages in accordance with D. You currently have y members and expect to have z members in five years. Finally, you explained you were created as a nonprofit because you were informed that F requires it in order for alcoholic beverages to be served at the event center, M.

Law

Section 501(c)(7) of the Code provides for the exemption from federal income tax of clubs organized and operated for pleasure, recreation, and other non-profitable purposes, substantially all the activities of which are for such purposes and no part of the net earnings of which inures to the benefit of any private shareholder.

Section 1.501(c)(7)-1(b) of the regulations states that a club which engages in business, such as making its social and recreational facilities available to the general public or by selling real estate, timber, or other products, is not organized and operated exclusively for pleasure, recreation, and other non-profitable purposes, and is not exempt under section 501(a).

Revenue Ruling 58-588, 1958-2 C.B. 265, holds that a social club that sells an unlimited number of memberships to so-called "members," who have no voice in the management of the club and whose only rights are to use the club's facilities upon payment of specified fees, is not a tax-exempt social club within the meaning of section 501(c)(7) of the Internal Revenue Code. Income from the members was, in reality, income from the

general public.

Revenue Ruling 66-225, 1966-2 C.B. 227, holds that a nonprofit organization which provides entertainment to its members does not qualify for exemption under section 501(c)(7) of the Code where it is controlled by a taxable corporation and operated as an integral part of such corporation's business.

Revenue Ruling 69-635, 1969-2 C.B. 126, holds that an automobile club whose principal activity is rendering automobile services to its members but has no significant social activities, does not qualify for exemption under section 501(c)(7) of the Code. The basis for this conclusion is the fact the club had no significant commingling of its members.

In *Chattanooga Automobile Club v. Commissioner, Warren Automobile Club, Inc. v. Commissioner*, 182 F.2d 551 (6th Cir. 1950), the United States Court of Appeals 6th Circuit held that to be exempt under the Act of Congress, a club must have been organized and operated exclusively for pleasure, recreation, and other non-profitable purposes. The court further specified that the words "other non-profitable purposes" must be construed as coming within the same classification as pleasure and recreation. In addition, there must be at least some sort of commingling of members to constitute a club. The court held that the two automobile clubs petitioning the court were not exempt under section 101(9) of the Internal Revenue Code of 1939 as a social club because the members of these clubs did not commingle.

In *Keystone Automobile Club v. Commissioner*, 181 F.2d 402 (3rd Cir. 1950), the United States Court of Appeals 3rd Circuit defined the word "club" to include some type of mingling of people together as well as a common object. In this case, the court held that the Keystone Automobile Club was not exempt under section 101(9) of the Code for a number of reasons one of which was because they saw no evidence of the commingling of members.

Application of law

You do not meet Section 501(c)(7) of the Code because your earnings are inuring to your founder, B through M. For example, your tax exempt status will enable you to apply for and obtain an alcohol license for private clubs. You indicated that M owned by your founder is willing to give you start up funds because M will benefit with the additional business; in addition, your lease agreement with M is contingent upon you getting a private club alcohol license in accordance with F state law. Inurement is indicated by the lease agreement provision that M gets r% of gross alcohol sales as well as the comprehensive management agreement showing M gets s% of gross alcohol sales. Finally, the agreements with M were not negotiated at arm's length as substantiated by the fact that B signed on your behalf as well as on M's behalf.

You do not meet the requirements in Treasury Regulation 1.501(c)(7)-1(b.) The facts that you have very limited requirements for membership and will issue unlimited memberships show you are not operating exclusively for pleasure, recreation, and other non-profitable purposes.

You are similar to the organization described in Rev. Rul. 58-588. Like the organization in the revenue ruling, social activities are not one of your material purposes but are merely incidental to the purpose of engaging in the sale of alcohol to the general public. For example, anyone can become a member by meeting the minimum requirements and you issue unlimited memberships. Therefore, income from your members is income from the general public. This shows that membership is not a true membership but is a guise under which unlimited

numbers of individuals may utilize your club which ultimately benefits M, which is owned by your president, B.

You are also like the organization in Rev. Rul. 66-225. You were organized by B as an integral part of M's business so M can use your alcohol license to increase sales. Therefore you are not organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes.

Like the organization described in Rev. Rul. 69-635, you are primarily providing services with insignificant or no commingling. By operating in such a way, you do not qualify for exemption under section 501(c)(7) of the Code.

You are like the organizations described in *Chattanooga Automobile Club v. Commissioner*, *Warren Automobile Club, Inc. v. Commissioner*, and *Keystone Automobile Club v. Commissioner*. You have not demonstrated that members have any interaction other than being at the same location to purchase alcohol. There is no common interest among your members and your social activities are only incidental. Because you have demonstrated very little, if any, personal contact among members and there is no expectation of personal contact among members, commingling is not a material part of your activities. Therefore you are not primarily operating in accordance with 501(c)(7).

Your position

You explained that M, which is owned by B, does not receive unreasonable management fees or excessive rent of facilities.

Our response to your position

Although you believe M does not receive unreasonable management fees or excessive rent of facilities, the facts indicate your earnings are inuring to B through M; for example, the percentage M is receiving for management fees and rent shows M is receiving almost one half of gross alcohol sales and there is no upper limit to the fees M may receive. Your budgets also show there is little remaining after making disbursements to members for alcohol, taxes and license renewal and fees paid to M. This shows M is sharing in your profits, which is inurement. This precludes you from exemption under section 501(c)(7).

Conclusion

Based on the information provided, we conclude that you are not operated for pleasure, recreation or other nonprofitable purposes described in section 501(c)(7) of the Internal Revenue Code. You do not meet the membership and commingling requirements for organizations qualifying for exemption from federal income tax under section 501(c)(7) of the Code and your net earnings are inuring to your founder, B through M. Accordingly, you do not qualify for recognition of exemption under section 501(c)(7) of the Internal Revenue Code.

If you don't agree

You have a right to file a protest if you don't agree with our proposed adverse determination. To do so, you must send a statement to us within 30 days of the date of this letter. The statement must include:

- Your name, address, employer identification number (EIN), and a daytime phone number
- A copy of this letter highlighting the findings you disagree with
- An explanation of why you disagree, including any supporting documents
- The law or authority, if any, you are relying on
- The signature of an officer, director, trustee, or other official who is authorized to sign for the organization, or your authorized representative
- One of the following declarations:

For an officer, director, trustee, or other official who is authorized to sign for the organization:
Under penalties of perjury, I declare that I examined this protest statement, including accompanying documents, and to the best of my knowledge and belief, the statement contains all relevant facts and such facts are true, correct, and complete.

For authorized representatives:
Under penalties of perjury, I declare that I prepared this protest statement, including accompanying documents, and to the best of my knowledge and belief, the statement contains all relevant facts and such facts are true, correct, and complete.

Your representative (attorney, certified public accountant, or other individual enrolled to practice before the IRS) must file a Form 2848, *Power of Attorney and Declaration of Representative*, with us if he or she hasn't already done so. You can find more information about representation in Publication 947, *Practice Before the IRS and Power of Attorney*.

We'll review your protest statement and decide if you provided a basis for us to reconsider our determination. If so, we'll continue to process your case considering the information you provided. If you haven't provided a basis for reconsideration, we'll forward your case to the Office of Appeals and notify you. You can find more information about the role of the Appeals Office in Publication 892, *How to Appeal an IRS Decision on Tax-Exempt Status*.

Where to send your protest

Please send your protest statement, Form 2848, if needed, and any supporting documents to the applicable address:

U.S. mail:

Internal Revenue Service
EO Determinations Quality Assurance
Room 7-008
P.O. Box 2508
Cincinnati, OH 45201

Street address for delivery service:

Internal Revenue Service
EO Determinations Quality Assurance
550 Main Street, Room 7-008
Cincinnati, OH 45202

You can also fax your statement and supporting documents to the fax number listed at the top of this letter. If you fax your statement, please contact the person listed at the top of this letter to confirm that he or she received it.

If you agree

If you agree with our proposed adverse determination, you don't need to do anything. If we don't hear from you within 30 days, we'll issue a final adverse determination letter. That letter will provide information on your income tax filing requirements.

You can find all forms and publications mentioned in this letter on our website at www.irs.gov/formspubs. If you have questions, you can contact the person listed at the top of this letter.

We sent a copy of this letter to your representative as indicated in your power of attorney.

Sincerely,

Jeffrey I. Cooper
Director, Exempt Organizations
Rulings and Agreements

Enclosure:
Publication 892